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IN THE

Supreme Court of the United States

October Term, 1944 — No. 953

JOHN F. X. FINN, as Trustee of CHILDS COMPANY
Petitioner

against

BURTON C. MEIGHAN, Jr., as Substituted Trustee under the Last Will and Testament of William T. Wood, Deceased
Respondent

PETITIONER'S BRIEF

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

October Term, 1944 — No. 953

JOHN F. X. FINN, as Trustee of Childs Company,
Petitioner,

against

BURTON C. MEIGHAN, JR., as Substituted Trustee under the Last Will and Testament of WILLIAM T. WOOD, Deceased.

BRIEF ON BEHALF OF PETITIONER

I. OPINIONS BELOW

The opinion below of the Circuit Court of Appeals for the Second Circuit (R. 43-45) is officially reported in 146 Fed. 2d, 594. The opinion rendered by the District Court for the Southern District of New York (R. 36-39) has not been officially reported.

II. JURISDICTION

The jurisdiction of this Court is invoked pursuant to Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C., Section 347) and Section 24(c) of the Bankruptcy Act.

III. STATEMENT OF CASE

Childs Company, the Debtor herein, is engaged in the business of operating a chain of restaurants. It has been a lessee of, and has operated a restaurant upon, the premises at 1553 Broadway, New York City, for more than 40 years. On July 31, 1922, the Debtor entered into a lease with a predecessor of the respondent landlord for a period of twenty-one years from May 1, 1926 to April 30, 1947 covering said premises (R. 5). (The lease was subsequently modified in respects not pertinent here.) The Debtor has a heavy investment in improvements and equipment in the leasehold (R. 17). Said lease contains the following provision (R. 5):

> "4. The tenant covenants that * * * if a petition in bankruptcy shall be filed by the tenant or if the tenant shall be adjudged bankrupt or insolvent by any Court, or if a trustee in bankruptcy of the tenant shall be appointed in any suit or proceeding brought by or against the tenant, then and in each and every such case, the term hereby granted shall immediately cease, determine and come to an end, and the landlord may recover and resume possession of the demised premises by any legal means."

On August 26, 1943, the Debtor filed a voluntary petition for its reorganization under Chapter X of the Bankruptcy Act, in the United States District Court for the Southern District of New York, and on that day the Judge entered an order approving the petition, and appointed John F. X. Finn trustee of the Debtor (R. 29). The petition for reorganization stated that the Debtor was unable to pay its debts as they matured (R. 29).

On May 9, 1944, the attorney for the Trustee of the Debtor wrote the landlord stating that the Trustee was desirous of assuming the lease at 1553 Broadway, New York, as modified (R. 28).

On June 23, 1944, almost ten months after the Trustee's appointment, the Trustee received a notice from the landlord stating that the lease "has ceased, determined and come to an end by virtue of the bankruptcy proceedings now pending in the United States District Court, Southern District of New York, relating to the Childs Company" (R. 25).

Immediately thereafter, by petition verified June 27, 1944, Burton C. Meighan, Jr., the respondent landlord, brought a petition in the United States District Court for the Southern District of New York, for an order adjudging that the lease of the Debtor had terminated (R. 4-7). The ground upon which the landlord based his petition was the filing of the petition for reorganization, as above set forth, and the appointment by the Court of petitioner as Trustee of the Debtor, which the landlord claimed was in violation of the forfeiture provision of the lease.

The courts below have held that the filing of the petition for reorganization containing the allegation that the Debtor was unable to meet its debts as they matured, and the appointment of the Trustee of the Debtor, pursuant to said petition, constituted an adjudication that the Debtor was "insolvent", in violation of the above quoted forfeiture provision of the lease, and that the lease had therefore automatically terminated on the day of the Trustee's appointment. The correctness of this determination presents an issue of law which is the sole question in this case.

The Trustee's petition for certiorari was granted by this Court, and the order thereon was filed on March 5, 1945 (R. 47). The order stated that "Counsel are requested to discuss in their briefs and upon oral argument the question whether the construction of the contract is governed by federal or state law" (R. 47).

IV. SPECIFICATION OF ERRORS

The Petitioner urges that the Circuit Court of Appeals for the Second Circuit erred:

1. In holding that the filing by the Debtor of a voluntary petition for reorganization under Chapter X of the Bankruptcy Act in which it was alleged that the Debtor is unable to meet its debts as they matured and the entry of an order by the District Court approving the petition, constituted an adjudication that the Debtor was "insolvent" in violation of the forfeiture clause contained in the lease between the parties.

2. In holding that the term "insolvent" as contained in said lease was to be construed as meaning inability to pay debts as they mature, as distinct from insolvency in the bankruptcy sense.

3. In that the decision of the Circuit Court of Appeals violates fundamental and general rules of construction with respect to forfeiture clauses in leases or other contracts, and has given the phrase in question in the lease an unjustifiable construction.

4. In failing to reverse the order of the District Court decreeing that the lease between the parties was terminated and directing the petitioner and the Debtor to vacate the premises in question.

V. SUMMARY OF ARGUMENT

The construction and effect of the clause in the lease, providing that the lease is automatically forfeited if the tenant is "adjudged * * * insolvent", directly involves the policy, administration, and interpretation of the Chandler Act. The fundamental purpose of Chapter X of that Act would in many cases be thwarted if valuable, and often

vital, assets were lost by the very fact of the institution of reorganization proceedings designed to conserve the debtor's property. Accordingly, under the principles laid down in *Prudence Corp.* v. *Geist*, 316 U. S. 89, the Federal law governs the construction of the forfeiture clause.

A definite Federal policy, as typified by this Court's decision in *Gaslay* v. *Williams*, 210 U. S. 41, and by pertinent provisions in Section 70b of the Bankruptcy Act, decrees that a forfeiture clause in a lease, which would deprive a debtor's estate of valuable assets by the fact of the institution of bankruptcy or reorganization proceedings should be most strictly construed. Although explicit and unequivocal forfeiture clauses may be enforcible, yet the Federal policy is so strong against such forfeiture clauses that they will not be given effect unless the condition for forfeiture upon which the landlord relies is unmistakably set forth.

The case of *Simmons* v. *National Tool Co.*, 110 Fed. (2d) 850 (C. C. A. 6) is directly in point, and contra to the decision of the Court below.

The Circuit Court of Appeals in the present case rested its decision primarily upon the proposition that every word in a contract should be given a separate and distinct meaning; it concluded, therefore, that in the phrase "adjudged bankrupt or insolvent by any Court", "insolvent" meant inability to meet debts as they mature, because, it claimed, a different view would involve "reading all meaning out" of the word. This reasoning, petitioner contends, contains a double fallacy. The forfeiture clause must be construed as a whole, and so construed, it appears that the clause is concerned only with bankruptcy proceedings and that "insolvent" is used in the bankruptcy sense of liabilities exceeding assets. The clauses which both precede and follow the phrase in question, deal only with bankruptcy. The phrase itself "adjudged bankrupt or insolvent by any Court", following as it does, the clause relating to *voluntary* bankruptcy proceedings, should be reasonably con-

strued as referring to adjudications in *involuntary* proceedings. The evident preoccupation of the clause in its entirety with bankruptcy and the application of the rule of *"ejusdem generis"* lead to the conclusion that "adjudged bankrupt or insolvent" was merely an alternative or emphatic expression of the same idea; that bankruptcy proceedings only were contemplated by the clause; and that the word "insolvent" is used in the bankruptcy sense.

If, however, it should be deemed that the words "or insolvent" should be given a separate meaning or purpose, it by no means follows that the conclusion of the Circuit Court of Appeals that "insolvent" was used in the sense of inability to pay debts as they mature, is correct. The phrase "adjudged * * * insolvent by any Court" should in that event be reasonably construed to apply to an adjudication of insolvency under the insolvency law of New York, which is set forth in sections 50-88 inclusive of the Debtor and Creditor Law of that State. This law is merely suspended and not repealed by the enactment of the Federal Bankruptcy Act. The lease was for a long term; the landlord would naturally intend to receive the same protection if the tenant were "adjudged insolvent" under the cognate State insolvency law as he would receive if the tenant were "adjudged bankrupt" under the National Bankruptcy Act, if that were in existence. No proceedings have been had under the State insolvency law; no adjudication that the Debtor is "insolvent" has been made under that law; and, in fact, *that law defines insolvency in the same way as does the Federal Act, namely, more liabilities than assets.*

Finally, various other statutory provisions and decisions at common law in New York have defined "insolvency" in the bankruptcy sense; if that word be interpreted in the light thereof, petitioner's construction is fortified.

In any event, the least that can be said is that the phrase is ambiguous. That being so, in view not only of

the strong federal policy above referred to, but also of the universal policy of strict construction where forfeitures are involved, we submit that the conclusion is irresistible that the word "insolvent" must be construed in the bankruptcy sense.

VI. ARGUMENT

POINT I

The construction of the clause of the lease here involved is governed primarily by Federal law. Federal policy clearly requires a most strict construction of a forfeiture clause which would operate to deprive a debtor's estate of valuable property by the fact of the institution of reorganization proceedings.

The order of the Supreme Court granting certiorari stated that "Counsel are requested to discuss in their briefs and upon oral argument the question whether the construction of the contract is governed by federal or state law" (R. 47). It is petitioner's position that the Federal law is applicable; that the said law clearly requires the construction which we urge; but that even if the law of the State of New York be applied, that law likewise requires the adoption of petitioner's construction.

We recognize, of course, that a Court of Bankruptcy will normally apply the law of a state in the construction of contracts made and to be performed therein, and in the determination of property rights created by or dependent upon the law of that state. It has, however, definitely and repeatedly been decided by this Court that where the interpretation or administration of a federal statute is involved, the federal and not the local law applies. This is particularly true where the federal statute expresses a policy concerning the specific subject matter involved.

Prudence Realization Corporation v. Geist, 316 U. S. 89;

Wragg v. *Federal Land Bank of New Orleans*, 317 U. S. 325;
Sola Electric Co. v. *Jefferson Co.*, 317 U. S. 173.

In considering the problem, it is important to determine whether the Bankruptcy Act does, in fact, purport to speak on the general subject of the effect of forfeiture clauses in leases in the event of bankruptcy or reorganization of a debtor. We find a definite expression of such a policy in section 70b of the Bankruptcy Act. That section contains a provision to the effect that:

> "A general covenant or condition in a lease that it shall not be assigned shall not be construed to prevent the trustee from assuming the same at his election and subsequently assigning the same; but an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same shall be enforcible."

The policy represented by this provision of the statute can be better understood if read in the light of the decision of this Court in *Gaelay* v. *Williams, Trustee, etc.*, 210 U. S. 41. In that case the question was whether the bankruptcy of a tenant operated to terminate a lease which provided for its forfeiture "if said lessee shall assign this lease or underlet said premises, or any part thereof, or if said lessee's interest therein shall be sold under execution or other legal process, without the written consent of said lessors." The Court held that the bankruptcy did not forfeit the lease, that it passed to the trustee in bankruptcy, and that the latter had the right to assign the lease to a third party, despite the prohibition against assignment by the lessee. This policy enunciated by the Supreme Court in the *Gaelay* case of applying a most strict construction in order to prevent a for-

feiture which would deprive the bankrupt's creditors of a valuable asset, was codified in 1938 in the above quoted provision in section 70b of the Bankruptcy Act.

The policy of the Bankruptcy Law does not go so far as to state that forfeiture clauses of this character are invalid if the instrument in question enunciates the precise contingency of forfeiture *in unmistakable terms.* If, however, the expression of the forfeiture clause is equivocal or if the scope of its application is subject to doubt, the policy as stated by the statute and by this Court itself in the *Gaslay* case requires a construction that would obviate forfeiture.

The existence of this policy is recognized by the text writers on Bankruptcy. Thus, in 4 Collier on Bankruptcy (14th Edition, 1942), the authors in discussing section 70b of the Bankruptcy Act, state (pp. 1240, 1241) as follows:

> "Partly because of the general disinclination of courts to support penalties and forfeitures, and partly in order to allow the trustee to make the most of any valuable asset he may find in the estate, ambiguous contractual clauses and covenants in leases referring to forfeiture of the lease with respect to the lessee's bankruptcy have universally been construed in favor of the lessee and his estate. It may even be said that for the lessee's or his trustee's benefit ambiguities have sometimes been read into a lease which the naked eye was at a loss to discover. This form of benign interpretation has been consistently indulged in when the courts were faced with general clauses or covenants forbidding or restricting an assignment of the lease. The rule that such a clause or covenant does not prevent the trustee from selling or assigning the lease or sub-letting the premises is of old standing, and it is now explicitly sanctioned by the Act itself. Section 70b distinguishes between a 'general covenant or condition' that a lease shall not be assigned, on the one hand, and, on

the other, an 'express covenant' that an assignment by operation of law or the bankruptcy of a specified party or of either party shall terminate the lease or give the other party an election to terminate. The former shall not be construed to prevent the trustee from assuming and assigning the lease. The latter, however, shall be recognized and enforced. The practical upshot of this distinction is a restatement and clarification of the warning to draftsmen that has for many decades been deduced from case law and which may be thus formulated: The law does not inquire what the parties actually meant and intended by a forfeiture clause in connection with the assignment of a lease; it requires a kind of sacred and inflexible formula, much in the manner of the *stricti juris* formulae of pre-classical Roman law. It is not enough to say that a lease shall terminate or may be terminated if assigned to anyone—that is too 'general'. It must be said that the lease shall terminate or may be terminated upon assignment by operation of law, or, still more specifically, that it shall terminate or may be terminated upon the bankruptcy of the lessee (or the lessor or both)—that is 'express' enough."

It is not necessary to go as far as the above quotation seems to indicate, in order to hold that the forfeiture clause in the present lease is not invoked by the appointment of a trustee in reorganization proceedings under Chapter X. But it is unquestionably true that a forfeiture provision must be explicit and unequivocal in its application in order to invoke it. In the present case, as we will show, not only is the clause ambiguous in so far as the words "adjudged • • • insolvent" are claimed to apply to proceedings under Chapter X, but a reasonable interpretation thereof leads to the conclusion that "insolvent" is used in the bankruptcy sense.

The policy of strict construction of forfeiture clauses in the case of ordinary bankruptcy is even stronger where

reorganizations under Chapter X are involved. Chapter X was enacted by Congress to provide a more satisfactory method for the reorganization of corporations which found themselves in temporary financial straits. Its purpose was to permit the business of such corporations to be continued and their assets preserved for creditors and stockholders, rather than have them partially or wholly destroyed by proceedings in bankruptcy or equity receiverships. In innumerable instances, corporate contracts, including leases, constitute assets which, in many cases, are vital to the continuance of the business. Many such corporate contracts contain clauses of the type involved herein. If the decision in the instant case of the Circuit Court of Appeals for the Second Circuit should in such situations be followed, the very filing and approval of the petition for reorganization would immediately operate to cancel such executory contracts and thus defeat in large part the very purpose of the reorganization proceedings, inasmuch as every voluntary petition for corporate reorganization must allege under Section 130 of the Act that the corporation is "insolvent *or that it is unable to meet its debts as they mature.*"

In the light of the foregoing discussion, it seems clear that under the principle announced in *Prudence Realization Corp.* v. *Geist, Trustee, supra*, the federal law is applicable. In that case, this Court refused to apply the New York rule that "a guarantor of mortgage certificates who also has an interest in the mortgage cannot share in the proceeds of its collection until the certificate holders are paid unless there is a clear reservation in the certificate of the right of the guarantor to share on a parity with other certificate holders." The Court applied the rule and policy, set forth in the Bankruptcy Law, of equality to all creditors. The Court said (p. 95):

> "But so far as the New York cases, without evidence of the actual intent of the parties, subordinate the guarantor on grounds of 'presumed intention' or

'the existence of special equities' or the 'natural equities' involved (citing cases), we are unable to say that the rule laid down is other than one of State law governing the relative rights of claimants in a State liquidation. Nothing decided in Erie Railway Company *v.* Tompkins, 304 U. S. 64, requires a Court of Bankruptcy to apply such a local rule governing the liquidation of insolvent estates. The Bankruptcy Act prescribes its own criteria for distribution to creditors. In the interpretation and application of Federal Statutes federal not local law applies (citing cases). The Court of Bankruptcy is a court of equity to which the judicial administration of the bankrupt's estate is committed, Securities & Exchange Commission *v.* U. S. Realty Co., 310 U. S. 434, 455-475, and it is for that Court—not without appropriate regard to rights acquired under rules of state law, to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class."

It is to be noted that in the *Prudence* case, the New York law recognized that an *explicit* statement in a mortgage certificate giving the guarantor a right to share equally with other certificate holders would be given effect; but the State policy refused to recognize equality or to interpret the certificate in such a way as to grant equality, in the absence of express and unmistakable language. The converse situation is true in the present case. It is the Federal law in the case at bar which, both by statute and by this Court's decisions, refuses as a matter of policy to recognize a forfeiture clause operating to deprive creditors of assets of the debtor, *unless the application of the invoked forfeiture clause expressly and unmistakably set forth.* In the *Prudence* case, the state

policy of strict construction gave way to the Federal policy of equality in distribution; in the instant case, the Federal policy of strict construction must likewise prevail; in fact, this policy, as we shall show, is in accord with the applicable State rule.

It should be remarked that neither this Court in the *Gazlay* case nor the Bankruptcy Act appears to have gone so far as to say that parties *cannot* provide that the contingency of bankruptcy or insolvency may operate to cancel a lease; they have clearly indicated, however, that the policy against forfeiture and against depriving creditors of a debtor's assets is so strong that explicit and unequivocal words must be used effectively to express any such intent. The policy of applying the Federal law in the present case would seem to be particularly clear in view of the fact that the institution of a proceeding under Chapter X—which is primarily designed to protect and conserve the debtor's assets, is seized upon as the ground for forfeiture of the lease and thus destroying what the statute was intended to conserve.

The decision in *Simmons* v. *National Tool Co.*, 110 Fed. (2d) 850, by the Circuit Court of Appeals for the Sixth Circuit, is directly in point, and in conflict with the decision herein by the Court below. In that case the National Tool Co. had a license under a patent to use certain grinding machines. The license contained a provision that "in the event of the bankruptcy, *insolvency* or dissolution of the National Tool Co., no title to said machines shall be vested in any receiver or trustee * * *" (italics ours). The National Tool Co. filed a petition for relief under Section 77B of the Bankruptcy Act in which it alleged that "the Debtor is unable to meet its debts as they mature* * *". The patentee contended that the filing and approval of the petition constituted an adjudication of insolvency of the National Tool Co. which operated as a cancellation or termination of the license. This is precisely the same claim which was made by the landlord in

the instant case. The Court flatly rejected this contention, stating, at page 850:

> "• • • it being the view of the court that the reorganization under Section 77B does not involve 'bankruptcy, insolvency or dissolution' in the sense those terms are used in the license agreement."

An examination of the record in the *Simmons* case discloses that the appellant in that case relied upon the cases in the Second Circuit of *In re Wil-Low Cafeterias, Inc.*, 95 Fed. (2d) 306 and *In re Walker*, 93 Fed. (2d) 281, which are the primary cases relied upon by the Circuit Court of Appeals for the Second Circuit in the case at bar. The Sixth Circuit obviously rejected the authority of said cases.

We proceed to inquire, therefore, whether the forfeiture clause here involved so explicitly and unmistakably applies to the proceeding under Chapter X as to necessitate the disregard of the policy above discussed.

POINT II

The term "insolvent" as used in the lease refers to insolvency in the bankruptcy sense.

Wholly apart from any question of policy as above discussed, and pursuing ordinary principles of construction, it seems clear that the word "insolvent", as used in the forfeiture clause, means excess of liabilities over assets rather than inability to meet obligations as they mature; and that the appointment of the trustee in the reorganization proceeding was *not* an adjudication of insolvency in the sense that this word is used in the lease.

It should be noted, preliminarily, that section 130 of the Bankruptcy Act setting forth the requisite allegations of a petition under Chapter X, says that "Every petition

shall state—(1) that the corporation is insolvent *or* unable to pay its debts as they mature." (Italics ours.) Clearly the words "unable to pay its debts as they mature" mean something other than insolvent; and it is undisputed that the Debtor is not "insolvent" in the sense that the word is used in the statute. Obviously, therefore, from the point of view of Chapter X itself, the granting of the petition for reorganization on the ground that the Debtor was unable to meet its debts as they mature, did not constitute an adjudication that the Debtor was "insolvent".

It is fundamental, moreover, that the clause of the lease in question *provides for a forfeiture,* that, wholly apart from the special policy discussed in Point I, forfeitures are not favored by the law, that provisions therefor will be strictly construed, and that all doubts must be resolved against the lessor. As Judge Learned Hand said in *Model Dairy Co., Inc.* v. *Foltis-Fischer, Inc.,* 67 Fed. (2d) 704, "It is true that courts do not look upon such conditions with a friendly eye, classing them as forfeitures," (citing cases).

The same principle of strict construction has been applied by the Court of Appeals of the State of New York in *Francis* v. *Ferguson,* 246 N. Y. 516. There the Court stated in part:

> "An ordinary covenant against assignment does not bind the executors of the tenant, and is not broken by a transfer of the leased premises by operation of law, Squire *v.* Learned, 196 Mass. 134; 81 N. E. 880; 11 L. R. A. (N. S.) 634, 124 Am. St. Rep. 525, 12 Ann. Cas. 977; Gazlay *v.* Williams, 210 U. S. 41, 28 S. Ct. 687, 52 L. Ed. 950. The covenant may, however, be so drawn as expressly to prohibit such a transfer. To accomplish such a prohibition in case of a devolution to executors, *its language must be 'very special'.* Seers *v.* Hind, 1 Ves. Jr. 294. *Such covenants are construed 'with the utmost jealousy'.* Higgs *v.* Pursell, 66 N. Y. 193, 201." (Italics ours.)

Professor Williston states the rule simply:

> "Therefore construction of a contract which would lead to a forfeiture cannot be favored." (3 Williston on Contracts (1936) Sec. 620, p. 1787.)

With this fundamental principle in mind, we proceed to the construction of the word "insolvent" as used in the lease. For convenience, we repeat the pertinent words in paragraph 4 of the lease (R. 5):

> "• • • if a petition in bankruptcy shall be filed by the tenant or if the tenant shall be adjudged bankrupt or insolvent by any Court, or if a trustee in bankruptcy of the tenant shall be appointed in any suit or proceeding brought by or against the tenant, then in each and every such case, the term hereby granted shall immediately cease, determine and come to an end • • •".

It is the petitioner's contention that the entire provision refers, in different ways, merely *to different forms of an ordinary bankruptcy proceeding;* and that "insolvent" is used in the bankruptcy sense of greater liabilities than assets.

The first clause of said provision—"if a petition in bankruptcy shall be filed by the tenant", refers to a *voluntary* bankruptcy proceeding. Then follows the second clause: "or if the tenant shall be adjudged bankrupt or insolvent by any Court". This, it would seem, reasonably applies to *involuntary* proceedings in bankruptcy resulting in an adjudication. The next phrase reads: "or if a trustee in bankruptcy of the tenant shall be appointed in any suit or proceeding brought by or against the tenant". Again we see that the parties in this provision concerned themselves just with bankruptcy proceedings—in this instance, the actual appointment of a trustee in bank-

ruptcy, whether the proceedings were voluntary or involuntary.

We accordingly have an elaborately phrased, but entirely consistent scheme, which concerns itself solely with bankruptcy, whether voluntary or involuntary. The intent was protection of the landlord against bankruptcy proceedings; it follows that the terms "bankrupt" and "insolvent" are used interchangeably.

The rule of *"ejusdem generis"* strongly supports our view. The word is used in the same phrase with "bankrupt" and is both preceded and followed by language which unmistakably refers solely to bankruptcy. The application of the *"ejusdem generis"* rule is clearly called for.

In view of the sedulousness which the lessor used in encompassing every phase of bankruptcy proceedings, the failure to mention other possible financial difficulties of the tenant indicates clearly that such other situations were not contemplated by this clause. There is no provision, for example, that the appointment of a receiver constitutes a ground of forfeiture, notwithstanding the frequency with which equity receivership proceedings were at that time resorted to. Nor is there any provision, quite common in leases, requiring the tenant to vacate any levy or attachment against its property. Nor does the lease declare that an assignment for the benefit of creditors shall be ground for forfeiture. In this respect the lease in question differs from those involved in *In re Wil-Low Cafeterias, Inc.*, 22 F. Supp. 617; *In re Walker*, 93 F. (2d) 281, and *Model Dairy Co., Inc.* v. *Foltis-Fischer, Inc.*, 67 F. (2d) 704—all in the Second Circuit. The Court below itself recognized this distinction, saying (R. 45): "It is true, as appellant urges, that in these cases the forfeiture clauses were more detailed than is the clause now under consideration; and it is likewise true, as was said in the *Model Dairy* opinion, *supra*, that such clauses are not viewed with 'a friendly eye'."

It is difficult to believe that a landlord who in the present case so meticulously sought to protect himself against the particular contingency of bankruptcy would have been so slip-shod and careless with respect to other contingencies if he had intended that they, likewise, should effect a forfeiture.

The Circuit Court of Appeals recognized the applicability of the rule that clauses providing for forfeitures must be strictly construed, but was of the opinion that its decision was necessitated in order to give "meaning to every word the parties use"; and that the construction for which petitioner contends "would deprive the words 'or insolvent by any court' of all utility; they would add nothing to the preceding words 'adjudged bankrupt'" (R. 45). This contention, as we shall show, contains a double fallacy.

In the first place, by applying the rule of *ejusdem generis*, it has been frequently held that several words may be used to convey a similar meaning. Indeed, in the very clause in question as above quoted, the parties stated that upon the happening of any of the grounds of forfeiture, "the term hereby granted shall immediately *cease, determine, and come to an end.*" Can it be seriously urged that separate meanings are to be attached to the respective words "cease", "determine" and "come to an end"? Moreover, the clause "if a trustee in bankruptcy of the tenant shall be appointed in any suit or proceeding brought by or against the tenant" is entirely unnecessary in view of the preceding phrases covering the contingency of the filing of a voluntary petition in bankruptcy by the tenant and the contingency "if the tenant shall be adjudged bankrupt or insolvent by any Court". In the very clause under consideration, therefore, we find several instances of the use of repetitious phrases merely for emphasis or excess of caution.

Our construction has, moreover, a sound practical basis. A landlord, reasonably enough, may not wish to be bound

to a lease with a bankrupt tenant. The very fact of bankruptcy means not only that the debts will not be paid in full, but that the debtor's business *will be liquidated.* The sooner the landlord obtains possession of the premises under these circumstances, the better off he will be. This is by no means true in the event of insolvency in the equitable sense. The debtor is likely to emerge from an equity receivership or a reorganization proceeding under Chapter X in stronger financial condition than before. The lease being assumed, the landlord is assured his full rent.

This argument is even stronger in the lease under consideration, where the very happening of the events of default expressly constitutes an *automatic cancellation of the lease.* If the rental value of premises covered by such a lease should substantially decrease, the landlord would have an advantageous lease terminated, and a fundamentally desirable tenant lost, irrespective of whether or not he desired it. It is difficult to believe that the landlord intended such a result.

The second fallacy in the reasoning of the Circuit Court of Appeals will be discussed in the next point.

POINT III

Assuming, arguendo, that the words "adjudged * * * insolvent" are to be construed as not relating to bankruptcy proceedings, then they should reasonably be construed to refer to an adjudication of insolvency under the New York Insolvency Law as set forth in the Debtor and Creditor Law of that State.

The Circuit Court of Appeals, as we have seen, based its decision upon the theory that in the phrase "adjudged bankrupt or insolvent by any Court", the word "insolvent" must be given a distinct meaning from that attached to "bankrupt". It thereupon concluded that "insolvent"

meant inability to meet debts as they mature. Even assuming, however, that the premise is correct, the conclusion by no means follows. If the two words are not intended to comprehend the same situation, then an obvious and reasonable purpose existed for the use of the word "insolvent" in addition to "bankrupt". The Federal courts, of course, have exclusive jurisdiction over bankruptcies in the administration of the National Bankruptcy Act. On the other hand, if, as has several times occurred in our history, no National Bankruptcy Act is in existence, then the respective State laws covering insolvencies are applicable. The State of New York has such an insolvency law. It is contained in sections 50 to 88, inclusive, of the New York Debtor and Creditor Law. This law has not been repealed by the enactment of the National Bankruptcy Act; it is merely suspended in operation.

Stellwagen v. *Clum*, 245 U. S. 605, 613.

Prior to 1898, the federal bankruptcy laws were short-lived and widely spaced in time. The Act of 1800 was repealed in 1803. The next legislation, enacted in 1841, was repealed in 1843. The Act of 1867 was repealed in 1878. (1 Collier on Bankruptcy, 14th Edition, pages 7-9.)

An entirely reasonable and understandable purpose of the language under consideration was to provide that an adjudication of *insolvency* under the State insolvency law should constitute a forfeiture during any period that the National Bankruptcy Act was not in existence. Debtors under the National Bankruptcy Act are adjudicated "bankrupt"; under the State insolvency law they are adjudicated "*insolvent*". The State insolvency law does not use the word "bankrupt". The words "adjudged • • • insolvent by any Court" would afford the landlord protection during any gaps when no national bankruptcy act was in force. It would seem clear, therefore, that if any separate purpose is to be attached to "or insolvent", that purpose was to cover the contingency of proceedings

under the New York insolvency law as set forth in the Debtor and Creditor Law. Obviously, there has been no adjudication under that law that the Debtor was insolvent.

It is of fundamental importance, moreover, to note that the definition of insolvency under the New York Debtor and Creditor Law is *not* inability to meet obligations as they mature, but an *insufficiency of assets to meet debts.* Thus, section 52 of that law, defining what a petition for an adjudication of insolvency must contain, states:

> "Sec. 52. *Contents of petition.*—The petition must be in writing; it must be signed by the *insolvent,* * * *; it must set forth, in substance, that *he is unable to pay all his debts in full;* * * *" (Italics ours).

We urge, therefore, that if any distinctive purpose were intended to be served by the use of the words "or insolvent" after "adjudged bankrupt", that reason was to cover the contingency of an adjudication of insolvency under the State insolvency law in the absence of a federal bankruptcy statute; that contingency has not occurred; and, indeed, the word "insolvent" as used in the State Statute *has precisely the same meaning as it has under the National Bankruptcy Act, namely, an insufficiency of assets to cover liabilities.*

POINT IV

To say the least, the meaning of "insolvent", as used in the clause in question, is ambiguous; accordingly, a construction should be adopted which would avoid a forfeiture of the lease.

An examination of the New York law discloses that in many instances, both under the Common Law and by Statute, insolvency has been defined in the sense of more liabilities than assets.

As we have seen, the Debtor and Creditor Law of that State, which in sections 50 to 88 thereof, sets forth a comprehensive insolvency law, defines an "insolvent" as one who is "unable to pay all his debts in full" (Section 52). Insolvency is similarly defined by the New York law in many other instances. Thus, in *Kane* v. *Larkin*, 131 N. Y. 300, 307, 308, the Court of Appeals of New York as early as 1892, long before the lease in question was made, stated (p. 307) in a case involving a fraudulent conveyance, that:

> "If the grantor remains insolvent after the conveyance and *has sufficient property left to satisfy all his debts*, then the conveyance, whatever his intention, cannot be a fraud upon his existing creditors." (Italics ours.)

And again:

> "But the person assailing the deed assumes the burden of showing that it was executed in bad faith and that it left the grantor insolvent *and without ample property to pay his existing debts and liabilities* and so it has been repeatedly held." (Italics ours.)

A similar definition of "insolvency" is contained in Article 10 of the Debtor and Creditor Law, dealing with fraudulent conveyances. Thus, section 271 states:

> "Insolvency. 1. A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured."

It is true that this section was enacted in 1925, after the making of the lease in question, but, as we have seen, it is merely a codification of the New York common law definition of insolvency as set forth in *Kane* v. *Larkin, supra.*

So, too, section 101 of the Debtor and Creditor Law (contained in Article 4 of said law dealing with "Insol-

vent's Exemption from Arrest and Imprisonment), provides as follows:

> "Section 101. Contents of Petition.—The petition must be in writing; it must be signed by the *insolvent* * * * it must set forth in substance, that he is unable to pay all his debts in full; * * *"

In section 955 of the Penal Law of the State of New York, which deals with "Transactions by Brokers and Dealers after Insolvency", insolvent is defined as follows:

> "Any person, firm, association or corporation shall be deemed insolvent within the meaning of this section whenever the aggregate of his or its property shall not, at a fair valuation, be sufficient in amount to pay his or its debts."

It would seem that these definitions of insolvency in New York, particularly in the Debtor and Creditor Law which purports to define the respective rights between parties in the relationship indicated by the title, would be most persuasive as to the meaning of the parties. *To say the very least, there is an ambiguity.* That being the case, since a forfeiture is involved, the ambiguity should be resolved in favor of the tenant.

CONCLUSION

It is respectfully submitted that the decision herein of the Circuit Court of Appeals for the Second Circuit should be reversed.

Dated April 5, 1945.

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